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Jacksonville (City of) FL

Pension Reforms Finalized, but Plan Calls for City to Pay Less Now, More Later

The Jacksonville, FL (Aa2 stable) City Council voted unanimously last month to adopt the mayor's pension reform plan, the final procedural hurdle in the city's long effort to address its pension cost and liability challenges. By eliminating defined-benefit pensions for new employees, the city will shed investment performance risk over time. However, Jacksonville will also provide costly new benefits and salary increases under the plan, which it can only afford because it will defer a significant portion of its legacy pension costs to the 2030s.

As of its most recent audited financial snapshot, Jacksonville's adjusted net pension liability (ANPL) reached $4.4 billion, or $2.2 billion on a reported basis. Relative to its operating revenues, Jacksonville's unfunded pension burden was the ninth highest among the 50 largest local governments in our most recent survey.

Effective in October, Jacksonville will close its three defined-benefit pension plans, joining San Diego, CA (Aa2 stable) in offering 401(k)-type defined-contribution plans to many new employees. Jacksonville goes further than San Diego, however, by ending its pension plans for all new hires, even public safety employees. Through negotiations with labor groups, Jacksonville's current employees will also increase their own contributions for pensions to 10% of pay from 8%.

Last year, Duval County, FL voters approved a half-cent sales tax to improve Jacksonville's pension funding. A current half-cent sales tax, which would have expired by 2030, currently goes toward infrastructure projects. The sales tax revenue for pensions will become available for pension funding in 2031, or sooner if certain infrastructure debt is retired early. In order for the city to access the sales tax revenue to reduce its pension burden, voters required that it close its pension funds. The sales tax for the city's pensions will expire when its plans reach 100% funding on a reported basis, but no later than 2060. While a group filed suit (case no. 16-2016-CA-004930) challenging the city's reform package vote and underlying legislation, a judge upheld the initiative on May 4.

The city's pension reform efforts come at a cost. While the city will carry no investment performance risk with the defined-contribution benefits for new employees, it will still contribute 25% of payroll for public safety employees. Public safety employees do not participate in Social Security.

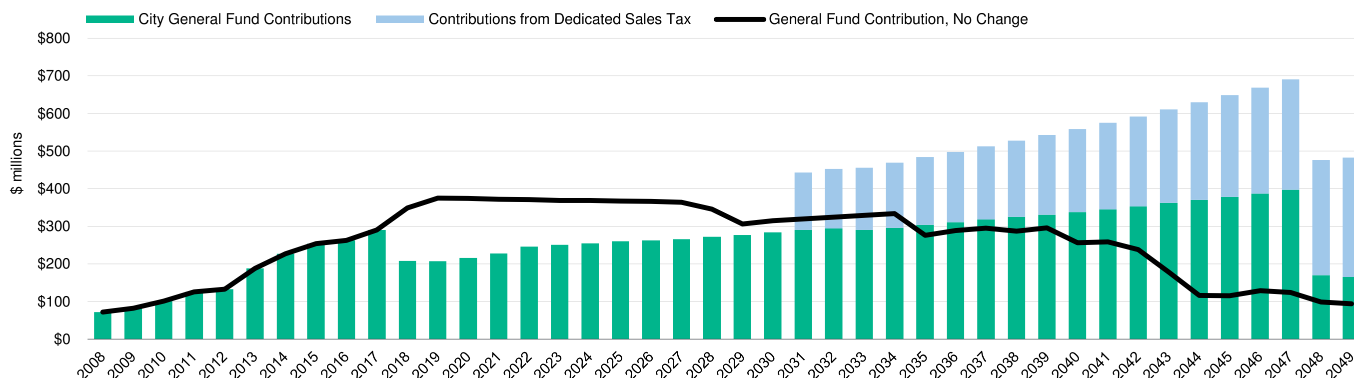
After foregoing salary increases for nine years due to it rising pension costs, the city also agreed to three years of substantial salary increases, beginning October 1, which is the start of the city's 2018 fiscal year. For example, several public safety employee groups will receive 6.5% salary increases in fiscal 2018 and 2019, and a 7% salary increase in fiscal 2020.

Employees will also receive one-time lump sum distributions of roughly 2% to 3% of salaries in the current fiscal year 2017. The fiscal 2018 pay raises will increase the city's annual costs by $37 million, while raises will add $40 million and $43 million of additional annual costs to its budget in fiscal 2019 and 2020, respectively. By 2020, these raises will increase the city's salary spending by $120 million annually, which will amount to roughly 10% of the city's general fund revenues by 2020, according to its projections.

Jacksonville will primarily offset these new costs by lowering its legacy defined benefit pension contributions. For example, contributions will fall by approximately $69 million in fiscal 2018 compared to fiscal 2017. The city will account for the dedicated future sales tax revenues as pension assets, which will reduce reported unfunded liabilities and thus lower its pension contribution requirements. Through this approach, the city will effectively lower its pension costs for the next 12 years, but it must significantly hike contributions once the new sales tax revenues become available (see Exhibit).

Exhibit 1

Jacksonville's Plan to Address Pension Challenges Calls for Paying Less Now, More Later



Note: City contributions include the new defined-contribution plan in 2018 and later, and assume the city's legacy defined-benefit plans hit annual investment return targets that range from 7.0% to 7.4%.
Source: City of Jacksonville

Jacksonville's reliance on future revenues, rather than current contributions, to address its pension underfunding will continue to negatively impact our key credit metrics related to its pensions. We expect the city's ANPL and “tread water” indicator to continue growing - because we do not consider future revenues as pension assets - while city contributions are going to be reduced.

The fiscal feasibility of Jacksonville shifting its pension costs to future years ultimately hinges on revenue growth for the next several decades. The more slowly that revenues grow, the longer the half-cent sales tax must stay in place, at least until 2060. The longer that the sales tax for pensions must stay in place, the more difficulty the city could face in garnering support for other revenue resources, should the need arise.

On the other hand, the city will immediately begin shedding investment performance risk relative to the status quo as new employees with only defined contribution benefits grow as a proportion of the city's work force. Furthermore, the city's plan will at least maintain minimum plan funding levels and contribution requirements, even before the new sales tax commences. Contribution hikes will be triggered if plan assets fall below liquidity thresholds and the city will never contribute less than $180 million to pensions in any year, under its plan.

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